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IN THE

Supreme Court of the United States

October Term, 1979

No. 79-1428

A. H. ROBINS COMPANY, INC., *et al.*,
Petitioners,

vs.

KALMAN ROSS and ANITA ROSS,
Respondents.

MOTION OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

KENNETH J. BIALKIN
LOUIS A. CRACO
HOWARD C. BUSCHMAN III
Attorneys for American Institute of Certified Public Accountants
One Citicorp Center
153 East 53rd Street
New York, New York 10022

Of Counsel
WILLKIE FARR & GALLAGHER
One Citicorp Center
153 East 53rd Street
New York, New York 10022

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The American Institute of Certified Public Accountants (the "Institute") hereby respectfully moves, pursuant to Rule 42(3) of the Rules of this Court, for leave to file the attached brief *amicus curiae* in support of the Petition for a Writ of Certiorari in the above captioned case.[1] The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 155,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops Generally

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[1] Petitioners have consented to the filing of this brief. Respondents' consent has been requested but refused.

Accepted Auditing Standards which form the standard of professional conduct for independent public accountants associated with financial statements, including those filed with the Securities and Exchange Commission.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed with respect to documents filed with the SEC. The Institute was invited to and did present its views before the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act (*Hearings on S. Res. 84 (72nd Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate,* 73rd Cong., 1st Sess., pt. 15 at 7027-10 (1934)) and, more recently, was accorded permission by this Court to file briefs *amicus curiae* in *Touche Ross & Co.* v. *Redington,* ——U.S.——, 99 S. Ct. 2479 (1979) and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). In light of that interest, the Institute will confine its brief *amicus curiae* to the issue of major significance to the accounting profession as a whole that is presented by a combination of the three questions tendered in the Petition for Certiorari. That issue may, for present purposes, be cast as follows:[2]

> May civil liability for misleading statements in documents filed with the SEC be judicially implied under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(a) (the "1934 Act") in favor of open market purchasers and sellers of securities beyond that provided by Congress in Section 18 of the 1934 Act, 15 U.S.C. Section 78r, when the plaintiff did not rely on such documents?

[2] The Institute does not express any position with respect to any other issue that may be subsumed in the issues presented by petitioners.

The court below answered this question in the affirmative. That decision, if upheld, imposes potentially unsupportable risks upon the performance of the audit function. The holding below sanctions a "market impact" theory of liability under Section 10(b) and would allow purchasers and sellers of securities to invoke a private cause of action created under Section 10(b) without even having seen, much less relied upon, the documents claimed to be misleading. The implications of the unsatisfactory analysis upon which that holding was reached transcend the interests of the parties litigant and are of disturbing significance to the accounting profession as a whole. The practical consequence of the decision below, if applied to auditors by reason of their association with financial statements included in documents filed with the SEC, will be the exposure of auditors to potentially unlimited liability to an indeterminate class.

The decision below expands the scope of the remedies for violation of Section 10(b) beyond that specifically provided for by Congress in Section 18. Such expansion is detrimental to the administration of the carefully balanced enforcement scheme based on industry self-regulation, SEC oversight and enforcement, and private remedies, that was enacted and intended by Congress.

The Institute seeks leave to file its *amicus* brief to demonstrate that the implication of a private remedy under Section 10(b) beyond the contours of Section 18 in this instance is not required or permitted by any correct interpretation of the statute or the legislative history, is not consistent with the governing precedents of this Court and is a matter of sufficient doctrinal and practical importance to warrant the issuance of the writ.

Respectfully submitted,

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KENNETH J. BIALKIN
LOUIS A. CRACO
HOWARD C. BUSCHMAN III
Attorneys for American Institute of Certified Public Accountants
One Citicorp Center
153 East 53rd Street
New York, New York 10022

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153 East 53rd Street
New York, New York 10022

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Preliminary Statement

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae,* in support of the Petition for a Writ of Certiorari, and urges this Court to review the Opinion and Judgment of the United States Court of Appeals for the Second Circuit entered in these proceedings on September 24, 1979.

Opinions Below

The opinion of the Court of Appeals reversing the decision of the District Court and remanding the case is officially reported at 607 F.2d 545 (2d Cir. 1979).

Question Presented

The three questions presented in the Petition for Certiorari[1] may be combined as follows:

> May civil liability for misleading statements in documents filed with the SEC be judicially implied under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78j(a) (the "1934 Act") in favor of open market purchasers and sellers of securities beyond that provided by Congress in Section 18 of the 1934 Act, 15 U.S.C. Section 78r, when the plaintiff did not rely on such documents?

Interest of the Institute as *Amicus Curiae*

The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 155,000 members. Among its purposes are the promotion and maintenance of high professional standards of practice and, in the pursuit of that purpose, the Institute has come to be accepted as the authoritative source of standards and procedures in its field. Most particularly, the Institute develops Generally Accepted Auditing Standards which form the standard of professional conduct for independent public accountants associated with financial statements, including those filed with the Securities and Exchange Commission.

The Institute accordingly has an obvious interest in the scope and bases of civil liability for damages sought to be imposed with respect to documents filed with the SEC. The Institute was invited to and did present its views before

[1] The Institute has not formulated and does not express any position with respect to the other issues that may be subsumed in the issues presented by petitioners.

the United States Senate concerning the scope of civil liability and damages to be provided in the 1934 Act (*Hearings on S. Res. 84 (72nd Cong.) and S. Res. 56 and S. Res. 97 Before the Committee on Banking and Currency of the United States Senate,* 73rd Cong., 1st Sess., pt. 15 at 7207-10 (1934) (the "1934 Hearings")) and, more recently, was accorded permission by this Court to file briefs *amicus curiae* in *Touche Ross & Co.* v. *Redington,* —— U.S. ——, 99 S. Ct. 2479 (1979) and *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

The implications of the holding below sanctioning a market impact theory of liability under Section 10(b) and allowing purchasers and sellers of securities to invoke a private cause of action under Section 10(b), and the implications of the unsatisfactory analysis upon which that holding was reached, transcend the interests of the parties litigant and are of disturbing significance to the accounting profession as a whole. The Institute here contends that the question of whether such a private right of action under Section 10(b) may lie under the facts of this case should be addressed at this stage prior to the growth of a "market impact" theory of liability into a "judicial oak" of even larger proportions than that which prompted the concern of this Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737 (1975) (*"Blue Chip"*). The holding below substitutes judicial preference for congressional intent as derived from the statute and legislative history. Because of the importance of this issue to the administration of the securities laws, this Court should address it.

Statement

A.H. Robins Company, Inc. ("Robins") is alleged to have misrepresented the effectiveness and safety of one of its products in its 1971 and 1972 Forms 10-K filed with the

SEC. Plaintiffs purchased 100 shares of Robins common stock in July 1973 over the New York Stock Exchange from third parties and sued, on March 23, 1977, on behalf of themselves and all purchasers of such stock from April 1972 through July 1974 when Robins allegedly first began to reveal that serious problems existed with the product. The amended complaint alleged that the defendants violated Section 10(b) of the 1934 Act and Rule 10b-5. Plaintiffs, however, do not claim that they ever saw or relied upon the filed statements alleged to be misleading. Rather, their theory is that the market reflected the misleading nature of Robins' statements.

The district court dismissed the amended complaint for failure to state a cause of action for violation of Section 10(b) and Rule 10b-5 and for failure to satisfy the pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure. In dismissing for failure to state a claim, the district court reasoned that Section 10(b) and Rule 10b-5 liability with respect to statements filed with the SEC could be no broader than the express cause of action provided in Section 18 of the 1934 Act. Thus, the court held that since Section 18 requires reliance, no cause of action had been stated.

On appeal, the Second Circuit held that maintenance of a cause of action under Section 10(b) and Rule 10b-5 would not nullify the terms of Section 18. It observed that under Section 10(b), scienter must be alleged and proved, while the presence of good faith and the absence of knowledge are defenses under Section 18. To the court, the shift of the burden of proof to the plaintiff in Section 10(b) cases helps to protect investors and "provides a rationale for dispensing with the reliance requirement inherent in § 18." 607 F.2d at 556.

REASONS FOR GRANTING THE PETITION

A.

The Holding Below Conflicts With Congressional Intent as Established Through Application of Governing Precedents of This Court.

Definition of the contours of liability under Section 10(b) brings to the fore an analytical process examining the language of the statute and its legislative history and taking into account the scheme of SEC enforcement, self regulation and express civil remedies created by Congress. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) ("*Hochfelder*"); *Blue Chip, supra. See also Touche Ross & Co.* v. *Redington*, —— U.S. —— , 99 S. Ct. 2479 (1979) ("Redington").[2]

Implication of a private cause of action in damages under Section 10(b) and Rule 10b-5 to create liability on a "market impact" theory in the absence of actual reliance finds no warrant in the provisions of the 1934 Act. The statute itself indicates that civil liability in damages with respect to misleading documents filed with the SEC was not to be created in favor of anyone who bought or sold a security without having relied upon those documents. The 1934 Act as a whole represents a sharply drawn congressional balance apportioning enforcement among administrative regulation, self-enforcement and liability to third

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[2] The importance of these contours cannot be understated. In the words of this Court, per Justice Frankfurter addressing a similar analytical setting:

> "[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequencies of his deviation from duty?"

Securities and Exchange Commission v. *Chenery Corp.*, 318 U.S. 80, 85-86 (1943).

parties. The legislative history persuasively confirms that Congress did not intend the construction advanced by the court below. It further shows that Congress, as part of its regulatory scheme, carefully circumscribed private rights of action in a fashion precluding the claims asserted here.

(i) The Text of the Statute Demonstrates Congressional Intent to Narrowly Circumscribe Civil Liability in Damages

This Court has repeatedly emphasized, particularly with respect to the securities laws, that "[t]he starting point in every case involving construction of a statute is the language itself." *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472 (1977), quoting *Hochfelder, supra,* 425 U.S. at 197, quoting *Blue Chip, supra,* 421 U.S. at 756 (Powell, J., concurring).[3]

In Section 18(a) of the 1934 Act, Congress expressly limited liability for misleading statements contained in documents filed with the SEC. In addition to exculpating defendants acting in good faith, the section limits the class of persons to whom defendants may be liable to those who purchased or sold "in reliance upon [the false or misleading] statement . . . at a price which was affected by such statement." The language employed by Congress thus sets forth a "double-barreled causation requirement."[4] A plaintiff must establish 1) that he relied upon the statement, and 2) that the statement affected the market price. Nowhere in the 1934 Act did Congress indicate any intention to

[3] For related authorities affirming this elementary canon of construction, see *Cannon* v. *University of Chicago,* 441 U.S. 677, 689 (1979); *United States* v. *Bass,* 404 U.S. 336, 339 (1971); Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 543 (1947).

[4] *Rich* v. *Touche Ross & Co.,* 415 F. Supp. 95, 103 (S.D.N.Y. 1976).

broaden the contours of such liability to cover those who merely purchased or sold "at a price which was affected by such statement".

The language of Section 10(b) says nothing in support of eliminating the reliance requirement. Reliance and scienter are the hallmarks of fraud[5] and, as this Court took pains to explain in *Hochfelder, supra,* 425 U.S. at 198, 212 n.32, manipulation, deception and contrivance as utilized in Section 10(b) are active terms, implying actual deception, totally contrary to the effect-oriented approach urged by the SEC. Those terms similarly give no hint that reliance is to be disposed of.

Acknowledgement by the court below that plaintiffs did not rely on the misleading statements is thus a concession that its holding goes beyond the express terms of the 1934 Act. Further inquiry is thus unnecessary. *See United States* v. *Campos-Serrano,* 404 U.S. 293, 297-98 (1971); *United States* v. *Bass, supra* note 3, 404 U.S. at 339; *Toussie* v. *United States,* 397 U.S. 112, 120-22 (1970); *United States* v. *Oregon,* 366 U.S. 643, 648 (1961).

(ii) The Legislative History: Congress did not Intend Civil Liability in Damages to the Market as a Whole

The legislative history demonstrates that Congress meant what it said in Section 18 in limiting liability for misleading statements filed with the SEC to those who relied on them.

The versions of Section 18 passed by both the House and Senate contained the actual formulation found in Section 18 in its final form. Both the Senate Report[6] and the

[5] *See* Restatement of Torts § 525 (1938).

[6] S. Rep. No. 792, 73rd Cong., 2d Sess. 21 (1934).

House Report[7] affirmed that liability in damages with respect to misleading statements contained in filed documents lies in favor of "a person who in reliance on the statement and in ignorance of its false and misleading character has purchased the security to which it relates at a price affected by it." And, as the Senate Report added, "the burden is on the plaintiff to show . . . the fact that the statement was false or misleading, and that he relied thereon to his damage." S. Rep. No. 792, 73rd Cong., 2d Sess. 13 (1934).

This consistent uniformity speaks not of indifference to potential liability to the market at large but of a conscious intent to restrict such liability. An earlier version basing liability only upon the absence of good faith and proof that the stock price was affected by a misstatement was "very much challenged on the ground that reliance should be required." 78 Cong. Rec. 7701 (1934). This restriction was insisted on, for example, by Chairman Rayburn of the House Committee on Interstate and Foreign Commerce in explaining the very bill he sponsored:

> "Mr. Hollister: The gentleman keeps referring to the issuer or the seller. This is a general clause and covers anybody making any kind of statement in any kind of document or in any kind of paper that is filed. It includes accountants, lawyers, or any other expert.
>
> * * *
>
> [A request of additional time was made]
>
> Mr. Rayburn: I want to read this part of the section to the gentleman:
>
> Who, in reliance upon the statement, shall have purchased or sold a security.

[7] H. R. Rep. No. 1383, 73rd Cong., 2d Sess. 25 (1934).

> Mr. Hollister: Yes; that is the man who is going to sue. I am talking about the report that is made. This refers to any statement that is made in any report under this bill, if it contains a misleading statement.
>
> Mr. Rayburn: If upon that report somebody bought or sold a security and lost money relying upon the statement that was false."

78 Cong. Rec. 8040 (1934).

Even with these limitations, the drafters of the 1934 Act expressed the concern that Section 18 went too far. Thomas Corcoran, one of its authors, and others were anguished over a long period of limitations which gave rise to the possibility of "blackmail". 1934 Hearings at 6565 (1934). The Institute expressed its concern over the amount of damages originally provided. *Id.* at 7207-10. These matters were addressed and the civil liability provisions of the 1934 Act and of the Securities Act of 1933, 15 U.S.C. Sections 77a-77aa (the "1933 Act"), were accordingly tightened. *Blue Chip, supra,* at 736, 740-41.

The decision below is thus not supported by the legislative history. Liability to the market on the basis of impact on trading prices was expressly rejected by Congress.

(iii) The Extrinsic Evidence From the Texts of Other Sections of the 1934 Act Shows the Error of the Holding Below

The interrelated nature of the various sections of the 1934 Act makes instructive an examination of the limitations on civil liability found in the Act. Since Section 10(b) is flanked by provisions creating private causes of action containing express limitations, this Court has

been "extremely reluctant to imply a cause of action in [another section] that is significantly broader than the remedy that Congress chose to provide." *Redington, supra,* 99 S. Ct. at 2488; *see also Blue Chip, supra,* 421 U.S. at 735-36.

With respect to plaintiffs' allegations that they purchased securities at prices affected by misleading reports filed with the SEC, Congress addressed the issue of filed misleading statements in Section 18 and the issue of manipulation in Section 9. The language employed in Section 18 and the congressional intent to preclude liability for market impact is clear. The holding below thus conflicts with this Court's holding in *Redington* that the language and intent of Section 18 are virtually conclusive in determining whether civil causes of action in damages under other sections of the 1934 Act may be implied.

This conclusion is further supported by the observation that where Congress intended to impose liability for false statements having market impact it knew how to do so. In Sections 9(a)(4) and 9(e) Congress expressly provided civil liability in damages for misleading statements having market impact. The persons subject to that liability, however, were limited by Congress to actual participants in securities transactions.[8] This carefully drawn limitation would be negated by interpretation of Section 10(b) to subject all those who merely file documents with the SEC and,

[8] Section 9(a)(4) makes it unlawful for "a dealer or broker, or other person selling or offering for sale or purchasing" a security registered on a national exchange to make a misleading statement to induce the purchase or sale of that security. That limitation of liability in market impact cases to participants in securities transactions was reinforced in Section 9(e). There Congress provided that "[a]ny person who willfully participates in any [such] act or transaction" is subject to civil liability in damages.

like accountants, are associated with such documents, to civil liability in damages.[9]

B.

The Decision Below Raises Disturbing Policy Implications That Should be Addressed by This Court.

It is against this background of uniform congressional refusal to permit liability to market purchasers per se, except as against participants in securities transactions as in Sections 9(a)4 and 9(e), that the decision below must be assessed. In relying on a shift of the burden of proof with respect to scienter in order to avoid Section 18, the court failed to correctly read the numerous significant decisions of this Court, some of which have reversed the Second Circuit,[10] requiring it to analyze the statutory language and history. Congress' intent to limit civil liability in damages was far more pervasive than recognized by the court below. Mere switch of the burden of proof on scienter can hardly justify judicial expansion of the judicially created cause of action under Section 10(b) to create a liability forsworn by Congress.

[9] Section 11 of the Securities Act of 1933 also creates liability in a strictly limited manner for misleading statements having market impact. As originally enacted, the Section provided a private right of action in damages to market buyers of registered securities where the registration statement contained a material untruth or omission, without regard to reliance. However, in 1934 Congress further restricted that cause of action by requiring the purchaser to show reliance on the prospectus once an earning statement covering a period of at least twelve months had been made generally available to security holders. Pub. L. No. 291, 48 Stat. 907 (73rd Cong. 1934). Thus, Congress in 1934 restructured Section 11 to fit the reliance requirement of Section 18 which pertains to annual reports filed with the SEC.

[10] *Redington, supra; Santa Fe Industries, Inc.* v. *Green, supra; Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1 (1977). *See also, Transamerica Mortgage Advisors, Inc.* v. *Lewis,* ____ U.S. ____, 100 S. Ct. 242 (1979).

Furthermore, the court's rationale in dispensing with reliance in market impact cases makes this case profoundly disturbing. Were scienter to be limited to actual intent to deceive, the rationale might be understandable if considered alone without regard to the congressional intent discussed *supra*. Several circuit courts, however, since this Court's decision in *Hochfelder*[11] have held that proof of recklessness may satisfy the scienter requirement in nearly all circumstances.[12] Yet the court below failed to articulate any justification for dispensing with reliance in recklessness cases.

By permitting possible liability upon proof of recklessness without requiring proof of reliance, the court below potentially subjected those, such as accountants who are associated with documents filed with the SEC, to "a liability in an indeterminate amount for an indeterminate time to an

[11] This Court in *Hochfelder* held that liability under Section 10(b) required pleading and proof of scienter by the plaintiff and defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud". It left open "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Hochfelder, supra,* 425 U.S. at 194 n.12.

In *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128 (1972), this Court did not dispense with the reliance requirement. Instead, the decision in *Ute* provides merely that no causation in fact need be shown in the context of face to face dealings where a material fact is withheld in violation of an obligation to disclose. The decision in *Ute* is thus of little relevance to an analysis of the propriety of a reliance requirement in market cases not involving face to face dealings.

[12] *See, e.g., Mansbach* v. *Prescott, Ball & Turben,* 598 F.2d 1017, 1023-24 (6th Cir. 1979); *Nelson* v. *Serwold,* 576 F.2d 1332, 1337 (9th Cir.), *cert. denied,* 439 U.S. 970 (1978); *Rolf* v. *Blyth, Eastman Dillon & Co.,* 570 F.2d 38, 44 (2d Cir.), *cert. denied,* 439 U.S. 1039 (1978); *Coleco Industries, Inc.* v. *Berman,* 567 F.2d 569, 574 (3rd Cir. 1977), *cert. denied,* 439 U.S. 830 (1978); *First Virginia Bankshares* v. *Benson,* 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied sub nom., Walter E. Heller & Co.* v. *First Virginia Bankshares,* 435 U.S. 952 (1978); *Sundstrand Corp.* v. *Sun Chemical Corp.,* 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied,* 434 U.S. 875 (1977).

indeterminate class".[13] Upon an allegation of recklessness, as upon an allegation of negligence,

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences."[14]

The desire of the court below to protect public investors fails to answer these concerns. The court's admitted decision to expand Section 10(b) in order to protect investors takes no account of the evident congressional decision to leave market impact cases to the enforcement branch of the SEC and disturbingly fails to recognize the potential exposure that its reasoning creates for those experts associated with filed documents.

Moreover, liability to the market on the basis of recklessness leaves auditors and others who are concerned with fulfilling their responsibilities under the securities laws with little if any guidance. The process of auditing the financial statements of a company does not yield absolute certitude about the result. The audit function proceeds by a process of sampling, which in turn rests upon the experience, expertise and informed judgment of the auditor. So barely defined is recklessness in application to the exercise of expert judgment[15] that its use, without the limitation of actual reliance, raises concerns at least equal to the concern for protecting investors articulated by the court below. Yet the decision makes no attempt to assess these factors or to draw an appropriate balance.

[13] *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, C.J.).

[14] *Id.* at 179-80; 174 N.E. at 444.

[15] *Pegasus Fund, Inc.* v. *Laraneta,* [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,281 (9th Cir. 1980).

This Court has frequently granted certiorari to review cases where the issue was important to the administration of the federal securities laws. *See Santa Fe Industries, Inc.* v. *Green, supra,* at 471; *Hochfelder, supra; Blue Chip, supra.* Where review was necessary to correct an important doctrinal problem, this Court has not hesitated to do so despite the nonfinality of the judgment sought to be reviewed. *E.g., Blue Chip, supra; Hochfelder, supra; United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837 (1975).

The holding below raises such sharp concerns requiring this Court's review at this stage. It contradicts the intent of Congress, expressed in Section 18 and in the legislative history, to preclude market-wide civil liability in damages absent actual reliance. And it poses grave implications to the scheme of SEC enforcement and private civil remedies enacted and intended by Congress.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

KENNETH J. BIALKIN
LOUIS A. CRACO
HOWARD C. BUSCHMAN III
Attorneys for American Institute of Certified Public Accountants
One Citicorp Center
153 East 53rd Street
New York, New York 10022

Of Counsel:

WILLKIE FARR & GALLAGHER
One Citicorp Center
153 East 53rd Street
New York, New York 10022